STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6959

Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont	)))	Hearing at Montpelier, Vermont April 4, 2006

Docket No. 7142

Investigation into Tariff Filing of Verizon New England Inc., d/b/a Verizon Vermont, in re: Compliance Filing in Docket 6959	)))

Order entered: 4/27/2006

PRESENT: James Volz, Chairman
John D. Burke, Member
David C. Coen, Member

APPEARANCES:[1] John Cotter, Esq.
for the Vermont Department of Public Service

Peter Zamore, Esq.
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for Verizon New England Inc., d/b/a Verizon Vermont

ORDER ADOPTING AMENDED PLAN

I. INTRODUCTION

On September 26, 2005, the Vermont Public Service Board ("Board") approved the Vermont Incentive Regulation Plan which altered the form of regulation for the predominant telecommunications carrier in Vermont, Verizon New England Inc., d/b/a Verizon Vermont

1. AT&T Communications of New England, Inc., Lightship Telecom and National Mobile Communications Corp., d/b/a SoVerNet Communications, are parties in Docket 6959, but did not participate in the Board's consideration of the Amended Vermont Incentive Regulation Plan.

("Verizon"). That Plan, which had a three-year term, provided marketing flexibility for Verizon, mandated rate reductions (which could be avoided through investment in broadband deployment), and set service quality standards.

Verizon and the Vermont Department of Public Service (the "Department")(collectively, the "Parties") have now asked that we approve an Amended Vermont Incentive Regulation Plan ("Amended Plan"). The Amended Plan calls for Verizon to increase its broadband deployment in the state so that by the end of 2010, 80 percent of Verizon's customers will have broadband service available (as opposed to the current 56 percent). In exchange, Verizon would not need to reduce its rates and would have greater flexibility in infrastructure investments, so long as Verizon continued to make investment and operating expenditures adequate to maintain the ongoing integrity of its network and the reliability and availability of its services.

In this Order, we approve the March 2, 2006, Memorandum of Understanding (the "MOU") which sets forth the agreement of the Parties to the Amended Plan and to certain modifications to the Orders of the Board in the above-captioned dockets. For the reasons contained in this Order, we approve the MOU, adopt the Amended Plan and include in the Order the provisions requested in the MOU. In particular, we find that Verizon's commitment to expand broadband services throughout its service territory over the next four and one-half years will provide significant value to Vermont ratepayers. At the same time, the existing Service Quality Plan and the new investment commitments will ensure that customers continue to receive high-quality service.

II. PROCEDURAL HISTORY

On September 26, 2005, the Board issued a Final Order in Docket 6959 that approved a Vermont Incentive Regulation Plan for Verizon. The Final Order required, in part, that Verizon implement an $8.18 million annual rate reduction effective as of July 1, 2005, and implement additional future rate reductions of $1.26 million effective July 1, 2007, and $1.80 million effective July 1, 2008. The Final Order also provided that part or all of the rate reductions could be avoided if Verizon made certain infrastructure improvements pursuant to a Network

Investment Incentive Plan. In addition, the plan required that Verizon invest $40 million annually in the state.

On October 11, 2005, and November 9, 2005, Verizon filed proposed tariffs designed to implement certain of the initial rate reductions required by the Board in its Final Order. At the request of the Department, Verizon agreed to delay the effective date of the tariffs (and thus the deadline for review of the tariffs pending Verizon's decision on whether it would file a Network Investment Plan).

On October 21, 2005, the Board issued an Order Re: Motion for Stay and Corrections to September 26, 2005 Order ("Stay Order") in Docket 6959 approving a Corrected Vermont Incentive Regulation Plan (the "Initial Plan"). Verizon filed a notice of appeal on October 25, 2005.

By letter dated December 21, 2005, Verizon advised the Board that it would not be filing a proposed Network Investment Plan. The Department then raised several concerns with Verizon's tariff filings to comply with the Docket Final Order. In response, the Board issued an Order opening Docket 7142 on January 6, 2006, that suspended the effectiveness of Verizon's proposed tariffs.

The Board convened a prehearing conference in Docket 7142 on January 12, 2006. Subsequently, the Parties entered into a Stipulation Re: Lifeline-Related Tariff Revisions ("Lifeline Stipulation") making certain bundled service offerings available to Lifeline customers, effective May 1, 2006.[2] By letter dated January 31, 2006, Verizon advised the Board of a plan to separately publish and distribute white and Yellow Pages directories ("Separation Proposal") in accordance with the Final Order.

Verizon and the Department filed the MOU and proposed Amended Plan on March 2, 2006. At the request of the Parties, the Supreme Court remanded Verizon's appeal to the Board for consideration of the Amended Plan. On March 16, 2006, Verizon and the Department filed supporting testimony of Pamela J. Porell and Christopher J. Campbell respectively. The Board held a status conference on March 21, 2006, and an evidentiary hearing on April 4, 2006.

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2. The Board approved this tariff filing by Order dated 3/22/06.

III. FINDINGS OF FACT

1. The MOU is the result of extensive negotiations between the Parties and contains a number of modifications to the Initial Plan. Porell supp. pf. at 1; Campbell pf. 3/16/06 at 5.[3]

A. Broadband Deployment Commitment

2. The Amended Plan replaces the Network Investment Incentive Plan with an agreement by Verizon to make available broadband capability to 80% of its access lines by December 31, 2010. The Amended Plan also specified the following interim milestones:

December 31, 2007	65%
December 31, 2008	75%
December 31, 2009	77 %

MOU at 3–4; Amended Plan at 7;[4] Porell supp. pf. at 2; Campbell pf. 3/16/06 at 3.

3. At present, approximately 56 percent of Verizon's 337,400 access lines are DSL-qualified. In October, 2004, Verizon announced that it would expand broadband services to 28 central offices. The Company completed that expansion in 2005 and those lines are included in the 56% qualified figure. The broadband commitment in the Amended Plan is new construction and does not include previous build-out commitments.[5] Tr. 4/4/06 at 26, 28, 30–31 (Porell).

4. Under the Amended Plan, broadband is generally defined to include Digital Subscriber Loop technology ("DSL") qualified lines and other, non-DSL wireline or terrestrial wireless technologies that provide for data transmission rates that are at least as high as those commonly available on DSL lines provided by Verizon in Vermont as of January 1, 2006, and that are equipped (as to DSL, in the Central Offices and Remote Terminals) to support data transmission

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3. Both Mr. Campbell and Ms. Porell testified previously in Docket 6959. Ms. Porell's testimony on the Amended Plan is referred to as the Supplemental Prefiled (supp. pf.). Mr. Campbell's testimony is referred to as Campbell pf. 3/16/06 to distinguish it from his previous testimony.

4. Verizon introduced the MOU as Exh. Verizon VT-PJP-1. The Amended Plan is attached to the MOU as Attachment I. Throughout this Order, we refer to the MOU itself (without the Attachment) as the "MOU" and the Attachment as the "Amended Plan."

5. As Ms. Porell stated: "The announcement in 2004 that added 28 additional offices has already been completed and is included in the 56 percent that we have today. I'm going further out into all of my central offices and increasing the number of qualified lines up to 80 percent of my total lines." Tr. 4/4/06 at 30.

rates of at least 1.5 Mbps downstream and 200 kbps upstream although actual transmission rates will vary because of loop lengths or other inherent limitations on a line or link. Amended Plan at 7; Porell supp. pf. at 3; Campbell pf. 3/16/06 at 15–16.

5. The loop length from the end-user to the Central Office or Remote Terminal, the condition of the line and the design of the line all affect the capability of the end user to receive the committed transmission rates and cannot be guaranteed. Porell supp. pf. at 4; tr. 4/4/06 at 21–22 (Porell)

6. The Amended Plan requires that the access lines be "qualified." DSL-qualified lines would be lines that are available for service on short notice. Any added outside plan work necessary to condition the line could be completed within normal ordering intervals. Tr. 4/4/06 at 21–22 (Porell).

7. Loops longer than 18,000 feet served by the central office are not DSL-qualified, although broadband service might be provided through a different technology. Tr. 4/4/06 at 22–24 (Porell).

8. The definition of broadband was revised from the Initial Plan to reflect the DSL technology that Verizon currently uses in Vermont to provide broadband and to permit the continued use of the current technology or other technologies that are appropriate for the provision of broadband. Verizon will determine the appropriate technology (DSL or some other technology) and will ensure that such technology meets the definition of broadband under the Amended Plan. Porell supp. pf at 4; tr. at 74–75, 96–97 (Campbell).

9. To the extent new, improved broadband-related technologies are developed in the future, Verizon will have an incentive under the Amended Plan to incorporate those technologies in meeting its broadband commitments. In this respect, the Amended Plan's definition of broadband is far broader and more flexible than a single technology, such as DSL or ISDN. Tr. 4/4/06 at 69–70, 73–75 (Campbell).

10. Although the rate at which Verizon is required to expand broadband service (as a percent of total lines) decreases during the term of the Amended Plan, the relative amount of construction increases because relatively more equipment (fiber, ATM switching, DSLAMs, etc.)

is needed to qualify lines served by the smaller central offices and remote terminals that are converted later in the term of the Amended Plan. Tr. 4/4/06 at 13–15 (Porell).

11. The broadband expansion plan is an extensive commitment for Verizon, requiring new equipment and extensive engineering of its infrastructure (e.g., fiber cable placement, pole line design and remote terminal redesign) on major construction projects. Assuming the use of currently deployed technology, Verizon would need to install equipment in all the remaining 34 Central Offices, including the Central Offices in New Hampshire that serve a portion of Vermont lines and close to 280 remote terminals. Porell supp. pf. at 4; Campbell pf. 3/16/06 at 5; tr. 4/4/06 at 38, 50 (Porell); tr. 4/4/06 at 95–96 (Campbell).

12. Verizon cannot meet its broadband expansion mandate by only provisioning the Central Offices. Verizon also will need to build out to remote terminals. Tr. 4/4/06 at 95–96 (Campbell, Porell).

13. Verizon will need to order over 300 DSLAMs, quadrupling the number of DSLAMs currently in the network. Verizon will also need to reengineer the Remote Terminals to upgrade and install this new equipment to provide DSL. Verizon also will need to acquire new rights-of-way and zoning permits to place many of these additional cabinets. Porell supp. pf. at 4; tr. 4/4/06 at 50 (Porell).

14. Verizon estimates that it will need to construct nearly 500 miles of fiber to Central Offices and Remote Terminals not currently served by fiber, requiring reengineered and newly constructed pole lines. Tr. 4/4/06 at 50 (Porell).

15. These construction projects required to meet the commitments in the Amended Plan affect not only Verizon but the associated electric and cable companies requiring rearrangement of their facilities as well. As a result of the Memorandum of Understanding in Docket No. 6957, some fiber construction projects required for the Amended Plan are already underway and are not scheduled for completion until 2009. Porell supp. pf. at 4.

16. The Amended Plan does not specify location for broadband expansion. Verizon intends to set its plans each year for the following year. Verizon retains flexibility as to where to implement the broadband deployment, although it does not intend to meet the milestones by

means of additional broadband deployment in the territory served by its Burlington central office. MOU at 4; tr. 4/4/06 at 33, 38 (Porell).

17. At end of the Amended Plan, although Verizon retains flexibility in its deployment, all Central Offices will have broadband capability. Tr. 4/4/06 at 38 (Porell).

18. In the absence of the Amended Plan, Verizon would continue the expansion of broadband, although the challenges of providing service where economically and technologically feasible would likely have limited further expansion. It is unlikely that Verizon would have significantly increased the level of broadband deployment. Tr. 4/4/06 at 31 (Porell); tr. 4/4/06 at 98–102 (Campbell; Porell supp. pf. at 5.

19. As the total number of Verizon's access lines changes, the number of additional broadband-qualified access lines needed to achieve broadband percentage milestones will vary. For instance, if Verizon's total access lines decrease due entirely to a decrease in DSL-qualified lines, the number of additional broadband-qualified lines needed to meet the Amended Plan milestones will increase. Tr. 4/4/06 at 34-35, 45-46 (Porell).

20. Verizon's broadband deployment obligations would not be affected by changes in jurisdictional separations or depreciation. Tr. 4/4/06 at 25 (Porell).

21. Upon achievement of the 80% broadband milestone, it is likely that 90-95% of Vermont households will have access to broadband through Verizon, independent telephone companies, cable, wireless service or some other means. Tr. 4/4/06 at 41-42 (Porell).

22. The broadband deployment obligations will fill a substantial portion of the current gap in broadband availability. Tr. 4/4/06 at 104 (Campbell).

23. By January 31 of each year until January 31, 2011, Verizon will file with the Board and the Department a report describing for the then-current year (1) any improvements tentatively planned and (2) the target percentage of working access lines for which broadband will become available for the coming year. The report will also describe, for the previous year, (1) any improvements completed and (2) the percentage of working access lines for which broadband is available. Amended Plan at 7.

B. Other Terms and Conditions of the MOU and Amended Plan

24. The Amended Plan extends the term of the Initial Plan from June 30, 2008, to December 31, 2010. Exh. Verizon VT-PJP-1 (Amended Plan at 1).

25. The extension of the term by two and a half years is needed to enable the Company to commit to extensive broadband deployment. The five-year plan is appropriate in order to secure the benefit of significant broadband expansion within Verizon's service territory and to enable Verizon to achieve the broadband targets in the Plan. Tr. 4/4/06 at 10 (Porell); tr. at 60–61 (Campbell).

26. The fundamental components of the Initial Plan, which are unchanged, remain reasonable over the longer, five-year term. Tr. 4/4/06 at 12 (Porell); tr. 4/4/06 at 66–67 (Campbell).

27. Additional competition over the longer term, for instance, will put greater pressure on the Company, and price caps will continue to protect customers if competition is less than expected. Tr. 4/4/06 at 62–63 (Campbell).

28. The Amended Plan incorporates a mid-term (2008) review as did the incentive regulation plan approved in Docket No. 6167 ("6167 Plan"), although the criteria are different. Tr. 4/4/06 at 15–16 (Porell); tr. 4/4/06 at 76–77 (Campbell). In particular, the Board may terminate the Amended Plan as of December 31, 2008, if Verizon fails to meet its broadband deployment obligations under the Amended Plan through December 31, 2008, or is in material violation of any other term or condition of the Plan, except that the Amended Plan shall not be terminated solely due to any accumulation of service quality compensation points below 75 in a calendar year. Amended Plan at 1; tr. 4/4/06 at 17–19 (Porell); MOU at 1; Porell supp. pf. at 2; Campbell pf. 3/16/06 at 3.

29. In addition, the Board retains its authority under 30 V.S.A. § 226b(i) to open an investigation and modify or terminate the Amended Plan, although any modification that is inconsistent with the MOU and Amended Plan would be contrary to the Parties' intent under the MOU. Tr. 4/4/06 at 16–17, 19 (Zamore) (representation by counsel); tr. 4/4/06 at 71–72 (Cotter) (representation by counsel).

30. Verizon will not be subject to cost-based rate decreases during the term of the Amended Plan or financial review in connection with rate decreases (not including revenue neutral rate restructuring under paragraph II(A)(1)(b) of the Amended Plan) to be implemented prior to the expiration of the Amended Plan, except as necessitated by Exogenous Events as defined by the Amended Plan. MOU at 5; Porell supp. pf. at 2.[6]

31. Verizon is not required to implement the rate reductions required by the Final Order, but the tariff filing offering bundled service packages to Lifeline customers will be implemented. MOU at 4; Porell supp. pf. at 2; Campbell pf. 3/16/06 at 17.

32. The MOU extends the deadline to file a depreciation study until December 31, 2009, or 12 months after early termination of the Amended Plan, whichever occurs earlier. MOU at 5; Porell supp. pf. at 2.

33. Verizon will maintain during the term of the Amended Plan separate publication and distribution of white pages and Yellow Pages in accordance with a plan filed with the Board on January 31, 2006. MOU at 4; Porell supp. pf. at 2-3.

34. The MOU also replaces the $40 million annual investment requirement with a requirement that Verizon maintain its infrastructure investment and operating expenditures at a level sufficient to maintain network integrity and the reliability and availability of its services. MOU at 4; Amended Plan at 6; Porell supp. pf. at 2; Campbell pf. 3/16/06 at 3–4.

35. The Retail Service Quality Plan ("RSQP") will be the primary benchmark for monitoring compliance with Verizon's obligation to maintain at all times a level of infrastructure investment and operating expenditures sufficient to maintain the ongoing integrity of its network and the reliability and availability of its services. Amended Plan at 6; tr. 4/4/06 at 53–54 (Porell); tr. 4/4/06 at 131–132 (Campbell).

36. The RSQP, which is substantively unchanged from the Initial Plan, measures a range of performance and provides a broad indication of Verizon's service. Measuring Verizon's

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6. The MOU states that Verizon would be exempt from cost-based rate decreases. However, the parties agreed that, with two limited exceptions, the Board could not order any decreases during the term of the Amended Plan. Tr. 4/4/06 at 20–21 (Porell); tr. 4/4/06 at 65, 77, 85–88 (Campbell). The only permitted rate changes would be a revenue neutral service restructure under Section II.A.1.b. or a reflection of exogenous changes as provided for in Section II.A.2. Tr. 4/4/06 at 85 (Campbell).

performance under the Service Quality Plan should be adequate to evaluate whether Verizon's investment has decreased to the point that it is affecting service. Tr. 4/4/06 at 53–55 (Porell); tr. at 132 (Campbell).

37. Under the MOU and Amended Plan, the term of the Retail Service Quality Plan is extended to December 31, 2010, subject to early termination as of December 31, 2008, consistent with the provisions of the Amended Plan. In addition, for 2006-2010, Verizon will file the quarterly reports identified in Section F(1) of the Retail Service Quality Plan on a monthly, rather than quarterly basis, and the reports shall (1) contain comparisons with prior year performance, and (2) identify any negative service quality deviations from the prior year's performance where the applicable 2005 benchmark was missed and Verizon's planned actions to address the deviations. Verizon will also file a report with similar information comparing 2005 to 2004 results. Amended Plan at 7–8.

38. Upon approval of the MOU, Verizon has agreed to withdraw its appeal of the Board Order approving the Initial Plan. Porell supp. pf. at 3; MOU at 6.

39. Other than as described previously, the Amended Plan retains the provisions of the Initial Plan.

40. It is not necessary to address the level of depreciation rates during the Amended Plan because the Amended Plan does not provide for a cost of service review or rate decreases during its term (except for specified reasons), and the Board will have the benefit of a new depreciation study in connection with its consideration of the type of regulation after the expiration of the Amended Plan. MOU at 5; tr. 4/4/06 at 11–13 (Porell); tr. 4/4/06 at 65, 85, 89 (Campbell).

41. The Board also retains its authority under Title 30 to impose sanctions if Verizon fails to meet its obligations under the Amended Plan including, for instance, the imposition of fines under 30 V.S.A. § 30. Tr. 4/4/06 at 52–53 (Zamore) (representation by counsel); tr. 4/4/06 at 78 (Campbell).

42. The measures contained in the RSQP are generally broad enough to identify developing problems in the network, although problems may also be identified through other means. Tr. 4/4/06 at 54–55 (Porell); tr. 4/4/06 at 132–133 (Campbell).

43. The Amended Plan's obligation to maintain network integrity and service quality and reliability does not require investments to enable new or enhanced services. Tr. 4/4/06 at 55–56 (Porell); tr. 4/4/06 at 133 (Campbell).

C. Statutory Analysis

General Good of the State [30 V.S.A. 226b(c)(1)]

44. The MOU promotes the general good of the state. This finding is supported by Findings 45 through 47, below.

45. With the Amended Plan, Verizon customers will experience the expansion of availability of broadband to 80 percent of the lines within five and a half years, a significant expansion that may not occur under normal market conditions. Porell supp. pf. at 5.

46. The Amended Plan promotes the general good by including specific plans for expansion of broadband availability and retaining many elements of the Initial Plan. Although the Amended Plan does not require rate reductions or specific investment amounts, its broadband expansion will result in a greater public benefit than the Initial Plan. Porell supp. pf. at 8.

47. The Amended Plan ensures that a substantial number of Vermonters will be able to receive broadband services from Verizon. Under the Amended Plan, Verizon will, by the end of 2010, provide mass-market broadband services to areas of the state that may not have had such access otherwise. Vermonters will have improved means with which to interact with other Vermonters as well as the rest of the world in their economic, educational, civic, and social life. Campbell pf. 3/16/06 at 19–20.

Telecommunications Purposes [30 V.S.A. 226b(c)(2)]

48. The MOU is consistent with the state telecommunications purposes established under 30 V.S.A. § 202c. This finding is supported by Findings 49 through 50, below.

49. 30 V.S.A. § 202c provides, among other things, that in order to direct the benefits of improved telecommunications technology to all Vermonters, it is the purpose of that Section to support universal availability of appropriate infrastructure and affordable services for transmitting voice and high speed data, provide for high quality telecommunications services and

provide the benefits of future advances in telecommunications technology. 30 V.S.A. § 202c(b)(2).

50. The Amended Plan is consistent with the statute through its expanded availability of broadband services. Porell supp. pf. at 8.

<u>Telecommunications Plan [30 V.S.A. 226b(c)(3)]</u>

51. The MOU is consistent with the Vermont Telecommunications Plan adopted by the DPS under 30 V.S.A. § 202d. This finding is supported by Findings 52 through 53, below.

52. The Vermont Telecommunications Plan at 8-5 states that:

> Network modernization and investment expectations should be an important element of any alternative regulation plan over the next five years. Alternative regulation plans should use milestones for marking and evaluating the company's ongoing progress toward transformation of telecommunications networks consistent with the infrastructure and service goals and specific desired improvements contained in this plan.

The Amended Plan is consistent with these goals due to Verizon's commitment to improve its network for future broadband services in accordance with specific expansion milestones. Porell supp. pf. at 9; Campbell pf. 3/16/06 at 18-19.

53. The Amended Plan will make substantial progress towards meeting the broadband goals of the State Telecommunications Plan; the Amended Plan will lead to an extension of service to areas in which other providers are unlikely to offer significant broadband coverage. Tr. 4/4/06 at 103–106 (Campbell).

<u>Quality Telecommunications Service [30 V.S.A. 226b(c)(4)]</u>

54. The MOU is consistent with the public's interests relating to appropriate quality telecommunications services because, in the Final Order, the Board found that the Retail Service Quality Plan it adopted would be consistent with the public's interest in quality service. The Amended Plan retains the Retail Service Quality Plan approved by the Board in its Order and therefore is fully consistent with this criterion. Porell supp. pf. at 9; Order of 9/26/05 at 176 and Appendix C.

Universal Service [30 V.S.A. 226b(c)(5)]

55. The MOU is consistent with the goal of protecting or promoting universal service to residential users of telecommunications. This finding is supported by Findings 56 through 57, below.

56. Although it retains Verizon's current level of rates, rather than implementing the rate reductions required in the Initial Plan, Verizon's current level of rates are generally the same as those approved by the Board in Docket 6167, which the Board found to be consistent with the goal of universal service. Porell supp. pf. at 9–10.

57. Although universal service has traditionally meant access to telephone service, the Vermont Telecommunications Plan at 5-7 recognizes that broadband is an emerging universal service issue. The Amended Plan assists in eliminating the disparities in the level of access to broadband throughout the state. Campbell pf. 3/16/06 at 18.

Telecommunications Infrastructure [30 V.S.A. 226b(c)(6)]

58. The MOU provides reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies. This finding is supported by Findings 59 through 62, below.

59. Under the Amended Plan, Verizon has committed to expand broadband capability to 80% of its access lines by December 31, 2010, and provides Verizon the flexibility to choose the most appropriate and efficient technology available, ensuring that Verizon will continue to upgrade its existing network to support new broadband services. Porell supp. pf. at 10.

60. Verizon must meet a certain level of performance (i.e. percentage of lines qualified) instead of spending specific amounts on specified investments, regardless of outcome, as provided under the Initial Plan. Campbell pf. 3/16/06 at 18.

61. If the Initial Plan is not modified, there will be rate reductions but likely no incentives to make infrastructure investments, because Verizon chose not to take advantage of the Network Investment Incentive Plan for the bulk of the rate reductions required under the Final Order. The Amended Plan provides firm commitments to modernize infrastructure. Campbell pf. 3/16/06 at 17–18.

62. Under the Amended Plan, Verizon has committed to maintain at all times a level of infrastructure investment and operating expenditures sufficient to maintain the ongoing integrity of its network and the reliability and availability of its services. Amended Plan at 6.

Economic Development [30 V.S.A. 226b(c)(7)]

63. The MOU reasonably supports economic development in the affected service territory. This finding is supported by Findings 64 through 65, below.

64. The MOU reasonably supports economic development in its service territory by making available Verizon's services at its current rates and by expanding the availability of broadband service. Porell supp. pf. at 10.

65. The lack of broadband availability in a substantial part of Vermont undermines the state's economic competitiveness. Ensuring that Vermonters throughout the state, including those in rural areas, have access to broadband for their economic future is more important for economic development than the rate reductions that would otherwise occur. Campbell pf. 3/16/06 at 16–17.

Consumer Privacy [30 V.S.A. 226b(c)(8)]

66. The MOU adequately protects consumer privacy interests because the Amended Plan retains the privacy provisions contained in the Initial Plan, which were found by the Board to satisfy this criterion. Amended Plan at 4; Porell supp. pf. at 11; Docket 6959, Order of 9/26/05 at 141.

Support of Competition [30 V.S.A. 226b(c)(9)]

67. The MOU supports reasonable competition by retaining the provisions in the Initial Plan relating to pricing flexibility, advance notice of price changes and price floors. Amended Plan at 4; Docket 6959, Order of 9/26/05 at 141.

<u>Non-Subsidization [30 V.S.A. 226b(c)(10)]</u>

68. The MOU includes adequate safeguards to insure that charges for noncompetitive services do not subsidize competitive services because it includes the Initial Plan's safeguards to insure against cross-subsidies through the provisions related to price floors. Amended Plan at 4; Docket 6959, Order of 9/26/05 at 141.

<u>Just, Reasonable, Non-Discriminatory Rates [30 V.S.A. 226b(c)(11)]</u>

69. The Amended Plan is just and reasonable and would not produce unjust discrimination between users of the public switched network in the pricing, quality, or availability of the network functions or services offered because it retains the Initial Plan's prohibition against unjust discrimination. Amended Plan at 3; Docket 6959, Order of 9/26/05 at 141.

IV. DISCUSSION

We adopted an Incentive Regulation Plan for Verizon seven months ago. As we described it in the Order, the key features of the Initial Plan were the following:

Traditional rate-of-return regulation is replaced by price regulation in which Verizon may not increase rates for existing services during the term of the Plan. Verizon is free to propose such rate reductions as it chooses and introduce new services (with no restrictions on pricing except that Verizon must meet price floors established in Dockets 5713 and 6077).

- At the outset of the Plan, Verizon must reduce its annualized retail rates by $8.18 million, by reducing business local exchange service rates and message toll service rates.[7] We also find that small rate decreases are appropriate in future years, directed towards residential service rates. Verizon may avoid these rate decreases if it elects to expand its broadband services to customers and areas that now have no broadband option and to which it would not otherwise offer broadband service.

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7. In Section III.A.1. of this Order, we accept the Company's assertion that its Yellow Pages operation is now separate from its white pages. To assure this separation, the Company must publish, distribute and market Yellow Pages separately from the white pages. If Verizon chooses to continue publishing and distributing the yellow and white directories together, the annual rate reductions increase by $7 million. The $8.18 million overearnings calculation assumes that Verizon elects to separate the Yellow Pages from the white pages as specified in the Order.

- The Board expects that Verizon will make further price reductions during the term of the Plan to reflect known cost shifts and respond to competition. The Board retains the jurisdiction to monitor the plan and Verizon's responses to such cost and market changes.
- The Plan continues the existing service quality standards (with minor changes), enforced through financial incentives, which will ensure continued high quality telecommunications service for Vermont consumers.
- Verizon will continue to receive significant discretion to deploy new services without prior Board review, allowing the Company to more rapidly respond to market forces.[8]

Verizon and the Department have now proposed that we modify that Plan. The framework of the Initial Plan remains unchanged. Verizon will receive increased flexibility to market new services. Protections for the competitive market place also are maintained. These include provisions barring unjust discrimination and cross-subsidization, including price floors to prevent Verizon from pricing services below their costs unfairly. The Amended Plan also retains the service quality standards.

The Amended Plan contains a number of significant changes, however. These include the following:

- Verizon commits to expand the availability of broadband services within its service territory from the present figure of 56 percent to 80 percent by the end of 2010. To enable this broadband expansion, the Parties have proposed that the term of the Plan be extended from three years to five-and-a-half years.
- The portions of our September 26, 2005, Order that required rate reductions at the outset of the Plan and further rate reductions in 2007 and 2008 are eliminated. In addition, Verizon would not be subject to earnings review or rate adjustments (with limited exceptions, during the course of the Plan).
- The requirement that Verizon continue to invest at least $40 million in network improvements annually is replaced with a requirement that Verizon maintain investment and operating expenditures sufficient to maintain the network, reliability, and service availability.
- The Plan is modified to incorporate a mid-term review during 2008. The review could be terminated at that time if Verizon failed to meet its broadband expansion targets or was in material violation of the Amended Plan.

8. Order of 9/26/05 at 6–7.

Verizon and the Department both maintain that these changes represent a benefit to Vermont consumers compared to the Initial Plan. Most significantly, they argue, Verizon will extend broadband service to a significant number of customers over the next four and a half years. This expansion in broadband service provides a greater value to customers than would the rate decreases, asserts the Department, particularly since Verizon would be unlikely to deploy broadband services as quickly otherwise.[9] In addition, both Verizon and the Department contend that eliminating Verizon's obligation to invest at least $40 million annually should not raise concerns since service quality standards remain and Verizon still must both invest and commit operational expenses necessary to maintain the network.

On balance, we find the Amended Plan to be an improvement over the Initial Plan and approve it. The key element of the Amended Plan is Verizon's commitment to extend broadband service so that by 2010, 80 percent of Verizon's customers will have such services available within normal provisioning intervals. Based upon Verizon's current number of access lines, the broadband deployment will extend to approximately 80,000 additional access lines.[10] This broadband commitment also represents new construction and does not include previous build-out commitments; thus, the agreed-to deployment is in addition to the broadband expansion that Verizon announced in October, 2004, and which the Company completed last year.[11] Verizon's commitment will result in all Central Offices serving Vermont (including the New Hampshire Central Offices that serve a number of Vermont exchanges) having broadband functionality. In addition, Verizon will extend service to some unserved portions of exchanges that now have broadband capability. Significantly, in order to be counted, an access line must be "qualified," which means that the customer can obtain service within normal ordering intervals (*i.e.*, less than 2 weeks).[12]

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9. Tr. 4/4/06 at 123-24 (Campbell).

10. Verizon now estimates that it has about 337,000 access lines in service. Tr. at 28 (Porell).

11. Tr. 4/4/06 at 30.

12. Tr. at 21–22 (Porell). In the past, measures of certain service availability have not taken into account whether the customer could actually obtain service. For example, DSL service is not available at distances greater than 18,000 feet (measured by the length of the cable) from the Central Office or remote terminal due to technological limitations inherent in the switches and protocols Verizon has deployed. Customers outside of that distance would not be considered to be "qualified."

In exchange for the commitment to deploy broadband services more widely, the Parties propose that we eliminate rate reductions that the Initial Plan required both at the outset ($8.18 million) and during the term ($1.26 million effective July 1, 2007, and $1.80 million effective July 1, 2008). These rate reductions would have reduced costs for Verizon's customers by approximately $52 million during the term that the Amended Plan would run.

For a number of reasons, we find this trade-off of rate relief for broadband deployment to be in the public interest. Our goal in adopting an incentive regulation plan and delineating its terms and conditions has never been solely to force rate reductions or to require that rates remain cost-based during the term of such a plan. The rate levels certainly are a relevant consideration, particularly at the outset of the plan; such a review at the outset is necessary to assure that the rewards derived from incentive regulation are based upon the company's efforts and are not the result of starting rates that produce excessive revenues. We have found that such a comparison is necessary to ensure, as required by the general good criteria of Section 226b(c)(1), that adoption (or continuation) of an alternative form of regulation will provide at least the same level of benefits as traditional regulation.[13]

However, rates are not the only consideration in our review. As we have said: "consumer benefit is the overarching goal of 30 V.S.A. § 226b."[14] The structure of both the Initial Plan and the Plan both would allow Verizon to have rates that are not cost-based. Such earnings flexibility is one component of the incentive regulation plans we have designed, although at the same time "incentive regulation is intended to produce higher earnings only as an incentive to produce increased value for consumers."[15]

Here, the positive elements of more widespread broadband deployment leads us to conclude that consumers will be receiving a benefit that, on the whole, outweighs the loss of the mandated rate reductions. In reaching this conclusion, we have considered the fact that the Amended Plan is predicated on our agreement to forego cost-based rate reductions during its term. We find this limitation acceptable. If Verizon meets its broadband commitments, Vermont

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13. Order of 9/26/05 at 21.

14. Dockets 6167/6189, Order of 3/24/00 at 117.

15. Order of 9/26/05 at 21.

ratepayers will receive significant value — access to broadband that many of them are unlikely to receive within a foreseeable time frame.

The change in the term of the Amended Plan, including the Service Quality and Reliability Plan, from three years in the Initial Plan to five and a half years, is also reasonable. The Parties made clear that the longer term was necessary to enable Verizon to make the broadband deployment commitment.[16] In addition, the Amended Plan includes a mechanism for terminating the Plan if Verizon fails to comply with all of the substantive requirements set out therein. This reopener provision is similar to the mid-term review that we found appropriate in the Incentive Regulation Plan we approved in Dockets 6167/6189 and will provide a useful reevaluation mechanism.[17] In addition, both the Department and Verizon made clear that the Board retains the authority to investigate the Amended Plan during its term under Section 226b)(i) and to impose penalties under Section 30.

Although we accept the Amended Plan based upon the Parties' representations, we remain concerned that many Verizon customers will still not have access to broadband services. Even at the end of 2010, Verizon may have as many as 20 percent of its customers — approximately 67,000 access lines — without broadband service. By contrast, the independent telephone companies have extended broadband availability to nearly all of their customers already. Meeting the goal of 80 percent broadband availability will provide a significant enhancement, but it also falls short of the state's telecommunications goals as reflected in the Telecommunications Plan. We are willing to accept the build-out set forth in the Amended Plan primarily because it provides for broadband deployment that would, in many cases, not otherwise occur, but the goal for Vermont should remain universal broadband access.

The Amended Plan also eliminates the minimum infrastructure investment of $40 million annually that we adopted in the Initial Plan. In its place, the Parties propose a requirement that Verizon maintain "a level of infrastructure and operating expenditures sufficient to maintain the ongoing integrity of its network and the reliability and availability of its service."

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16. Tr. at 10 (Porell); tr. at 60–61 (Campbell).

17. Unlike Dockets 6167/6189, the Board could not use this mid-point reevaluation to terminate or adjust the Amended Plan based upon Verizon's earnings or rates. As part of an overall plan that includes significant value to consumers that could not be otherwise obtained — increased broadband deployment — we can accept this provision.

Although we have some reservations, we conclude that the investment and expenditure commitment in the Amended Plan, coupled with the other elements of the Plan, is reasonable, especially in light of the fact that it is the result of an MOU. We adopted the investment requirement because of our concern that competing demands for money throughout the corporation, including DSL services and wireless deployment, could undermine other network investments necessary to ensure that Verizon maintained its high-quality network.[18] These concerns remain, particularly as incumbent carriers devote additional attention to unregulated ventures. Nonetheless, we expect that the alternative set out in the Amended Plan will provide adequate protection for ratepayers. First, it affirmatively requires Verizon to invest sufficient capital to maintain its network at a high quality. Second, the SQRP, which is essentially unchanged from the Initial Plan, will provide a mechanism to monitor whether capital deployment is adequate. Third, the modified investment condition includes not only investment, but also requires Verizon to commit sufficient operating expenditures. This represents an enhancement over the Initial Plan. For example, Verizon has failed to adhere to the Residential Repair standard in the SQRP over the last three years. To the extent that this failure is the result of insufficient staffing and resources, the modified condition would appear to require Verizon to correct the problem.

Verizon also has committed to additional monitoring of performance as a result of the MOU. In particular, Verizon will file additional service quality reports designed to identify both changes in service quality and, more importantly, Verizon's planned actions to address these deviations. In addition, Verizon will now file specific reports delineating its progress on broadband deployment as well as outlining each year's planned build-out.

It is possible that Verizon may seek to sell some or all of the access lines in its Vermont service territory. If such a transfer were to occur, we would expect that the purchasing company would, at a minimum, be bound to the broadband deployment commitments set out in the Amended Plan.

Finally, the Amended Plan leaves in place the other components of the Initial Plan, the bulk of which were also encompassed in the Docket 6167 Incentive Regulation Plan. These

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18. Order of 9/26/05 at 122–123.

provisions include conditions designed to create a fair competitive framework and the rules for introduction and pricing of service. We note that one new provision of the Initial Plan, Section II.B.8., requires Verizon to propose a plan for allocating revenues between services if it bundles interstate and intrastate services. Verizon now offers a number of such bundles. It is thus important that the Company submit its proposal soon so that we can ensure that a reasonable allocation of revenues occurs.

V. CONCLUSION

We find that the MOU and Amended Plan satisfy all of the criteria of 30 V.S.A. § 226b and that the public interest favors approval as requested by the Parties. In particular, Verizon's commitment to make 80 percent of its lines broadband qualified over the term of the Amended Plan will deliver value to the citizens of the State of Vermont greater than that which would be realized under the previously ordered rate reductions.

VI. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The Memorandum of Understanding between the Department of Public Service and ("Verizon"), including the Amended Vermont Incentive Regulation Plan (the "Amended Plan") is approved, effective immediately. The Amended Plan is set out in Appendix A to this Order..

2. The requirement in Docket 6959 that Verizon file tariffs reflecting a reduction in its revenue requirement (Order of 9/26/05 at ¶ 185) is hereby eliminated.

3. Verizon shall maintain throughout the term of the Amended Plan, the Separation Proposal described in its letter to the Board of January 31, 2006.

4. Verizon's services will not be subject to cost-based rate decreases during the term of the Amended Plan or financial review in connection with rate decreases (not including revenue neutral rate restructuring under paragraph II(A)(1)(b) of the Amended Plan) to be implemented prior to the expiration of the Amended Plan, except as necessitated by Exogenous Events as defined by the Amended Plan.

5. The deadline for Verizon to file a depreciation study is extended until December 31, 2009, or 12 months after early termination of the Amended Plan, whichever occurs earlier.

6. Verizon shall comply with the reporting requirements set out in the Final Order, as modified by the Order of March 22, 2006, in Docket 6959.

7. By January 31 of each year until January 31, 2011, Verizon shall file with the Board and the Department a report describing for the then-current year (1) any improvements tentatively planned and (2) the target percentage of working access lines for which broadband will become available for the coming year. The report also shall describe, for the previous year, (1) any improvements completed and (2) the percentage of working access lines for which broadband is available.

8. Verizon shall withdraw its appeal of the September 26, 2005, Order in Docket 6959.

Dated at Montpelier, Vermont, this 27th day of April, 2006.

s/James Volz	)	PUBLIC SERVICE
s/David C. Coen	)	BOARD
s/John D. Burke	)	OF VERMONT

OFFICE OF THE CLERK

FILED: April 27, 2006

ATTEST: s/Judith C. Whitney
Deputy Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.